Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Request to Update Default Compensation Rate	)	WC Docket No. 03-225
For Dial-Around Calls from Payphones	)	
	)	

REPLY COMMENTS OF THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL

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SUMMARY

Payphone deployment has fallen by 31 percent over the last five years and all indications are that deployment will continue to fall in the near future. The Commission must increase the dial-around rate to slow the decline.

IXCs do not offer a solution to this precipitous decline, rather, they embrace it. They argue that market forces should determine payphone deployment. Sprint even goes so far as to claim that the PSPs' are not taking out their payphones fast enough.

The IXCs' position, however, is internally inconsistent: they voice support for letting the market work while simultaneously arguing that the Commission should keep an artificial cap on dial-around rates. The way to allow the market to work is to remove the artificial cap on dial-around rates, so that PSPs can find out for themselves what the market will bear.

In any event, the record rebuts the IXCs' position that substantial drops in payphone deployment are consistent with the public interest. There is ample evidence showing the inadequacy of the current level of payphone deployment. Payphones are becoming more and more difficult to locate and people from all walks of life are being deprived of needed service.

Some IXCs argue any unmet public need for payphone service can be filled through the state public interest payphone ("PIP") programs. PIP programs cannot provide a complete solution; rather, their recent revival is a symptom of a larger

problem, *i.e.*, inadequate overall payphone deployment. PIP Programs, which examine the need for payphones on a location-by-location basis, cannot possibly adequately address the massive reductions in payphone deployment. To let the market fail, and then rely on PIP programs to correct the market, would be an abdication of the Commission's responsibility under Section 276 of the Act.

The IXCs also cannot refute that coin callers are currently subsidizing dial-around callers by paying a greater share of payphones' joint and common costs. The Commission must increase the dial-around rate to eliminate this market distortion.

The IXCs also argue that the Commission should paternalistically protect PSPs from a rate increase that allegedly will reduce PSPs' revenues and payphone deployment. The IXCs' elasticity argument should be rejected. First, it is not only contrary to market principles, but also simply unlawful for the Commission to prevent PSPs from recovering their costs based on speculation that demand for dial-around service might be elastic. In any event, there are built-in market-based safeguards, such as PSPs' and IXCs' ability to negotiate a lower rate, that ensure that the rate will be reduced if it is set too high.

Even if the Commission could find that demand elasticities are relevant, however, it is virtually certain that demand for dial-around service is *inelastic* and that an increase in the dial-around rate will *increase* PSPs' revenues. The fact that the majority of dial-around calls are subscriber 800 calls for which payphone callers do not pay a penny virtually guarantees that demand for dial-around calls will be inelastic. In addition, AT&T's own data, while flawed, suggests that call volumes will decrease by a very small amount in response to APCC's proposed rate increase.

APCC's Cost Study methodology, contrary to the IXCs' assertions, is consistent with the Commission's methodology in the *Third Payphone Order*. APCC did not err by including in its study payphones that did not break even. APCC included payphones that both generated slight economic losses and slight economic profits in order to calculate call volumes at the average break-even payphone.

The IXCs also claim that individual cost elements should not have been included in APCC's Cost Study and/or that APCC's estimates of such costs are inaccurate. For example, the IXCs assert that PSPs should not be permitted to recover their collection costs. The fees that PSPs pay aggregators to collect dial-around compensation are substantial and are likely to increase, since PSPs will once again be required to collect dial-around compensation from switched-based resellers. The IXCs' concern that including collection expenses will cause PSPs to double recover is groundless.

The IXCs also contend that PSPs should not be afforded the same opportunity as every other business to recover their bad debt. Contrary to the IXCs' assertions, the case law does not support denial of recovery for bad debt. APCC's method of factoring in bad debt is reasonable and should be approved.

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The American Public Communications Council ("APCC") submits the following reply to the comments filed in response to the *Notice of Proposed Rulemaking* ("*NPRM*"), FCC 03-265, released October 31, 2003. In the *NPRM* the Commission requests comment on "whether to modify the default rate of payphone compensation for 'dial-around' calls set forth in section 64.1300(c) of our rules." *NPRM*, ¶ 1.[1]

The comments confirm that in order to effectively promote the widespread deployment of payphone services, the Commission must increase the compensation rate substantially. The comments of the interexchange carriers ("IXCs") who oppose a rate increase fail to rebut in any material way the cost studies independently prepared by the APCC and the RBOC Coalition, which concur in showing that the fair cost-based

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1 The Commission released the *NPRM* in response to petitions by APCC and the Regional Bell Operating Companies ("RBOCs"). *See* APCC, "Request That the Commission Issue a Notice of Proposed Rulemaking (or in the Alternative, Petition for Rulemaking) to Update Dial-Around Compensation Rate," filed August 29, 2002 ("APCC Petition"); RBOC Payphone Coalition, "Petition for Rulemaking to Establish Revised Per-Call Compensation Rate," filed September 4, 2002 ("RBOC Petition"). The RBOC Payphone Coalition consists of BellSouth Public Communications, Inc., SBC Communications, Inc. and the Verizon telephone companies.

compensation rate in the current, dramatically altered payphone market is $.48 - .49 per call.

I. THE COMMISSION MUST ACT TO ENSURE THE WIDESPREAD DEPLOYMENT OF PAYPHONES

A. The Current Level Of Deployment Cannot Be Deemed Adequate To Serve The Public Interest

None of the commenting parties disputes that the ready, affordable access to the network offered by payphones is declining.[2] Notwithstanding the express language of Section 276, however, the IXCs argue that "widespread deployment" of payphones need not be maintained unless the Commission finds that widespread deployment is in the public interest. AT&T Comments at 4-7; WorldCom Comments at 5-6; Sprint Comments at 5. *See also* 47 U.S.C. § 276(b). Sprint claims that the problem is not too few phones but too many phones. *Id.* at 8.

In determining the appropriate deployment level, the Commission's five-year old finding that the deployment level existing in 1998 was adequate, provides absolutely no basis for *presuming*, five years later, that a deployment level 31% lower than the 1998 level is also adequate. If the Commission is going to remain faithful to its responsibilities under Section 276, it cannot sit passively while payphone deployment drops lower and lower. Inaction cannot be justified based on an unsupported and unsupportable presumption that *Third Payphone Order* findings of adequate payphone deployment remain valid under the radically changed circumstance that one-third of

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[2] As discussed in APCC's and some IXCs' comments, payphone deployment began to drop in 1998, when according to Commission data, the number of payphones deployed was about 2.15 million. *See Third Payphone Order* at 2629, ¶ 184 n.390. The Commission found that this level of deployment was consistent with Congress's goal of widespread deployment of payphones. *Id.* at 2610, ¶ 143. From 1998 to March 31, 2003, the number of payphones dropped by approximately 650,000, a decrease of 31 percent. *Trends in Telephone Service*, Table 7.6.

these phones have evaporated. *Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* Third Report and Order and Order on Reconsideration of the Second Report and Order, 14 FCC Rcd 2545 (1999) ("*Third Payphone Order*").

The record provides no reasonable basis for the Commission to conclude that the current level of payphone deployment is even adequate, much less excessive.[3] Indeed, the record strongly supports the opposite conclusion: The current deployment level is clearly inadequate.

1. There is ample evidence that the current level of payphone deployment is inadequate to serve the public

APCC's Petition cited numerous articles showing the inadequacy of the current level of payphone deployment. *See, e.g.,* Shienne Jones, *Lack of payphones makes campus unnecessarily dangerous,* Daily Reveille (Baton Rouge, LA), Apr. 18, 2001 (describing problems caused by removal of payphones from a university campus) (attached to APCC Petition as Att. 4); Christopher Boyd, *Tuesday's tragedy highlights value of payphones,* Orlando Sentinel (Orlando, FL), Sept. 17, 2001 (describing long lines at payphones following September 11, 2001 terrorist attacks) (attached to APCC Petition as Att. 5); Bettina Boxall, *Removal of many payphones poses problems for small town residents,* Los Angeles Times, Jan. 22, 2001 (attached to APCC Petition as Att. 11).

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3 Sprint speculates that the drop in payphone deployment may be primarily caused by the removal of "redundant" payphones that were installed in banks adjacent to other payphones. Sprint Comments at 8. This is highly unlikely. According to the responses to APCC's cost study survey of randomly selected independent payphones, more than three quarters of the independent payphones in the current (as of 2002) payphone base are the only payphone at their locations. Decl. of Don J. Wood, ¶ 33 ("Wood Reply Dec.") (attached as Exhibit 1).

More recently, the level of concern about the availability of payphones has heightened even further. For example, in Pennsylvania, a community organization leader explained the impact that phone removals are having on the poor:

> [Berks Community Action Program director William F.] Richardson said people faced with [the choice between paying for heat, electricity, or telephone service] usually chose to let the phone bill go rather than lose heat or electricity. So when pay phones start disappearing from street corners, the poor may be forced to walk blocks to call a doctor or make other necessary calls.

Dan Kelly, *Loss of public phones can hurt poor,* Reading (PA) Eagle, March 11, 2003 (attached as Exhibit 2). Another article discusses similar problems:

> As BellSouth and other major phone comp[anies yank pay telephones across the Southeast and nationwide because of the explosive increase in wireless phones, thousands of poor people are being cut off from essential services.
>
> * * *
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> Pay-phone providers will install telephones even in unprofitable locations if someone is willing to pay a monthly fee to have them there. But Nilesh Patel, manager of the phone-free Texas Motel in Monroe, La., said that after BellSouth yanked the pay phone in his parking lot – one of 7,000 pulled by the company in that state – he couldn't afford to have it replaced. They wanted a guarantee of at least $50 a month, and I had to pay the difference if there weren't enough calls," he said.

Wes Smith, *Decrease in pay phones rings alarm; As companies hang up on service, social activists and migrant groups worry,* Orlando (FL) Sentinel, January 13, 2004 (attached as Exhibit 3). In vacation areas like Maryland's Eastern Shore, the impact on residents and vacationers is different, but no less real:

> Only about 35 of the 105 public phones in Ocean City will remain after Verizon begins removing them in the next few weeks, Ocean City Councilman Vince Gisriel said. . . . Gisriel said he asked Verizon to keep some phones in Ocean City for public safety, but the company declined. "So streets where people once saw three or four phones there will only be one," he said. "While I understand the reasons for removing them, we're a host community to more

> than 8 million people a year, and not everybody has cell phones yet." Gisriel said it isn't just Ocean City where he is noticing the disappearance of pay phones. "Driving from Salisbury to Ocean City there aren't very many left," he said. "You really have to ride around and look for them."

Joe Carmean, Jr., *Verizon booths,* Daily Times (Salisbury, MD), February 24, 2003 (attached as Exhibit 4).

Public service commissions are increasingly expressing concern about the impact of the decline in payphone deployment. As discussed in APCC's comments (APCC Comments at 6), a West Virginia Task Force directed to monitor payphone availability in the state found that "after the general decline in payphone availability, removal of even a single payphone can have a dramatic impact on rural areas." West Virginia Public Service Commission, Payphone Task Force, *Sixth Interim Report* at 5 (2003) ("*West Virginia Report*"), available at http://www.cad.state.wv.us/03pp%20Survey.htm. In addition, "the substantial decline in the number of payphones in West Virginia over the last two years means that many areas – especially rural areas – are on the edge of market failure." *Id.* at 1, *quoted* in APCC Comments at 8-9.

Other States have also begun to examine the problem of payphone availability. The Maine Public Service Commission and the Kentucky Public Service Commission recently opened inquiries into the need for a "public interest payphone" ("PIP") policy. Maine Public Utilities Commission, Docket No. 2003-420, *Regarding the Provision of Payphone Service in Maine,* Notice of Inquiry, June 17, 2003; Kentucky Public Service Commission, Case No. 2003-00261, *Petition of BellSouth Public Communications, Inc. for Withdrawal from Provision of Payphone Service in Kentucky,* Order entered December 24, 2003.

These findings and actions by State public service commissions contrast strongly with the earlier findings by the same State commissions, on which the FCC relied five years ago in setting the current $.24 rate. At that time, the Commission noted that the Maine Commission had found that "'a public interest payphone program is unnecessary due to the wide availability of payphones in Maine,'" and that "the West Virginia Commission found no need to take any additional regulatory actions to address 'market failures' in the deregulated payphone market." *Third Payphone Order* at 2611, ¶ 143 n.288. The Commission relied on such statements by PSCs to conclude "that the current approximate level of deployment most appropriately satisfies Congress's stated goal of promoting widespread deployment of payphones to the benefit of the general public." *Id.* at 2610, ¶ 143.

In the *Third Payphone Order*, the Commission viewed State commission interest, or lack thereof, in public interest payphones as a test of whether there was a need to increase the level of deployment by adjusting the dial-around rate, and found that the then-current level of deployment was roughly adequate. Today, public concern about inadequate payphone deployment levels is strongly surfacing, making clear that the deployment level can no longer be considered adequate. In response, State commissions are launching reviews of PIP programs. The State commissions' responses are thus symptoms of the overall problem. That does not mean, however, that PIP programs are an effective and appropriate remedy for inadequate payphone deployment, as the IXCs claim. They are just the only remedy available to *State commissions*. As discussed below, a dial-around compensation rate increase, which can be accomplished only by the FCC, is a far more effective and efficient means of ensuring adequate payphone deployment.

2. If the Commission is to rely on "market forces," as the IXCs advocate, then it must raise the "default" dial-around rate so market forces can operate freely

The IXCs contend that the Commission should allow "market forces" alone to determine demand for payphones. *See, e.g.*, AT&T Comments at 7. Relying on a single footnote in the *Third Payphone Order*, ¶ 141 n.282, the IXCs argue that the Commission has ruled that any decline in payphones resulting from increased use of wireless merely reflects the operation of the market and does not justify review of the dial-around rate. The cited footnote cannot be used to justify such patently circular reasoning.[4] In that footnote, the Commission merely observed that the *then–current 1998* level of deployment,[5] which the Commission found to be an appropriate level, could be reduced in the future as a result of decreasing wireless prices in a "competitive marketplace." Nothing in the footnote or elsewhere in the *Third Payphone Order* conceivably supports the proposition that the Commission may dismiss a continuous five-year, 31-percent decline in payphone deployment as merely the result of "market forces." As discussed in Section II.A below, the IXCs' elasticity argument reveals that it is the IXCs who seek to hide from "market forces" by maintaining an artificially low cap on dial-around compensation.

Furthermore, the IXCs' "market forces" argument contradicts itself. As the FCC explained in the *Third Payphone Order*, the only way to let market forces operate freely in

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[4] The IXCs ignore their own argument's circularity while contending that the Commission's marginal-payphone rate methodology is circular. It might be plausibly argued that the Commission's methodology is circular if the Commission were to apply it without consideration of the appropriate deployment level. It is indisputably circular, however, for the IXCs to argue that "market forces" generated by the currently prescribed dial-around rate will automatically ensure an appropriate level of deployment and thereby remove any necessity to revisit that same prescribed rate that is bringing about the cited market effects.

[5] No one is proposing that the Commission attempt to maintain the 1998 level of payphone deployment. At best, the rates proposed by APCC and the RBOC Coalition would preserve the current level of payphone deployment, which is more than 30% lower.

the payphone industry is to remove the artificial cap on dial-around rates so that PSPs can find out for themselves what compensation rates the market will bear. If the IXCs were truly interested in letting market forces determine the level of payphone deployment, they would support the deregulation of dial-around compensation. At a minimum, they should be urging the Commission to raise the cap so that there is room for the market to seek an appropriate rate within some ultimate limit that defines a clearly excessive rate. The fact that no IXC supports such FCC action[6] shows the bankruptcy of their "market forces" argument. On the contrary, by urging the FCC to impose a confiscatory rate on PSPs, the IXCs seek to shift onto PSPs the burden of the IXCs' own unwillingness to let a rate be negotiated in and mediated by the marketplace.

As the Commission noted in the *Third Payphone Order* and several other orders, "market forces" have no ability to operate as long as PSPs are precluded from either blocking access codes or setting their own dial-around rates. As the IXCs concede, the Commission specifically found that, in order to apply the marginal payphone method, it had to "deduce an appropriate level of payphone deployment." *Third Payphone Order* at 2610, ¶ 143, quoted by AT&T Comments at 5. There would be no need to "deduce an appropriate level" if the Commission could simply rely on market forces to establish the appropriate level. Indeed, if market forces were sufficient, there would be no need to prescribe dial-around compensation at all. In fact, far from relying on market forces, the Commission looked for evidence of whether public convenience, health and welfare were being satisfied by the current deployment level. The fact that the Commission

[6] As discussed in Section VI below, Sprint's tired "caller pays" proposal cannot be considered a true market-based approach. Under caller-pays, PSPs would remain subject to the blocking restrictions that have prevented the emergence of a true dial-around market. Instead, PSPs would be forced to create an artificial market that changes the fundamental nature of both the dial-around services (*i.e.*, "toll-free" calling) offered by IXCs *and* the payphone service (coinless calling) offered by PSPs.

found, in the *Third Payphone Order*, a lack of evidence of concern by State commissions regarding public interest payphones would have been irrelevant if the only appropriate response to such evidence of concern is the implementation of public interest payphone programs.

3. Public interest payphone programs alone cannot ensure widespread deployment of payphones

The IXCs also argue that the Commission should promote widespread deployment solely through targeted subsidies implemented by State public interest payphone ("PIP") programs. WorldCom Comments at 7-8; Sprint Comments at 5-7. As noted above, however, concern about public interest payphones is a symptom of a larger problem, *i.e.*, inadequate overall deployment, that is far too large to be conceivably addressed through PIP programs. State PSCs focus their regulatory response on PIP programs because those programs are the only mechanisms available to the States under the regulatory scheme of Section 276. While PIP programs can prove useful in addressing specific, narrowly defined gaps in payphone availability, such programs are not intended to, and cannot, provide an adequate remedy for the removal of payphones on a massive scale. Where there is an overall lack of adequate deployment, that is a problem for the FCC to address as part of its overall responsibilities under Section 276 – and in particular through the prescription of payphone compensation rates.

State PIP programs operate by exercising judgment on an individual basis as to whether payphones should be placed in specific locations. As explained by Pennsylvania Public Utilities Commission Consumer Assistance and Complaints Division Chief David J. Lewis:

> "We recently had the commissioners of a rural county contact us about a pay phone that was removed from an intersection where a store did a seasonal business. . . ." Lewis said he also has received calls from private consumers complaining that pay phones are being removed from their urban neighborhoods. "We handle each request to keep or replace a pay phone on a case-by-case basis," Lewis said.

Dan Kelly, *Loss of public phones can hurt poor,* Reading (PA) Eagle, March 11, 2003. Such case-by-case adjudications cannot possibly address efficiently the problems arising from the removal of more than 600,000 payphones.[7]

Indeed, it is curious that IXCs advocating reliance on "market forces" would support, as the sole remedy for inadequate deployment, a method that is indisputably far more regulatory and far less efficient than is the prescription of a new dial-around

[7] As an example of how public interest programs operate, *see* Exhibit 5, an opinion issued by the New Hampshire Public Utilities Commission ("PUC") in 2002 approving a petition for designation of a single phone, located at a country store, as a public interest payphone. The petition was filed on March 27, 2002, public notice was given on April 15 and a pre-hearing conference was held on May 17. Representatives of six community organizations, in addition to Verizon, the Office of the Consumer Advocate ("OCA") and the PUC staff, appeared at the pre-conference. Four of those organizations, as well as Verizon, a health care organization, the OCA, a State representative and a State senator filed written comments supporting the petition. The PUC Staff then conducted an investigation and filed a report on June 17. The Commission reviewed the report and on July 9 issued a 10-page opinion approving the petition. Had the Commission not acted favorably, the petitioner could have requested a formal hearing on whether the payphone should be designated a public interest payphone. After approving the petition, the Commission requested proposals on how to fund the payphone and established a schedule for the funding issue culminating in a hearing to be held on October 24, 2002. Thus, the entire process, which actually moved relatively speedily for a regulatory process, consumed at least seven months and clearly, many person-hours of regulatory resources, and resulted in the placement of one payphone.

compensation rate. While modifying the dial-around rate is not a true "market" solution, it is the most efficient way in the absence of call blocking, to address declining payphone deployment and prevent further massive payphone removal. By taking such action, the FCC will increase the ability of PSPs to recover the costs of maintaining payphones, and thereby stem declining deployment through the most efficient, "market-based" mechanism available.

B. Even Assuming That The Current Deployment Level Is Barely Adequate To Serve The Public, The Commission Must Act To Prevent Further Erosion In the Level Of Payphone Deployment

Even if the Commission could find that the current level of payphone deployment is just adequate to serve the public, the Commission has no basis to conclude that deployment will stabilize at the current level. There is every reason to expect that the decline in deployment will continue or accelerate. The Southeast, where BellSouth is scheduled to exit the payphone market completely as of March 31, 2004, is illustrative:

> "BellSouth would love for the private pay-phone providers to take over every location, and that's just not going to happen," said George Sowards, executive director of the Kentucky Payphone Association. Plenty of companies will be eager for high-traffic, high-profit locations, but it may be hard to persuade companies to put phones in remote or sparsely populated areas that generate few calls. Such locations may need pay phones the most, argues Winchester Mayor Dodd D. Dixon, who filed comments with the PSC concerning BellSouth's exit from the market.
>
> The Louisville-based Metro Human Needs Alliance, which is made up of 30 community nonprofit and governmental agencies, also raised a caution flag over the decline of pay phones, arguing in a filing with the PSC that the phones "provide basic communication" for many low-income clients.
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> * * *
>
> Despite the state's rules on pay-phone access, 10 local exchanges in BellSouth territory have no public coin phones. . . . In addition,

> BellSouth is the only company supplying pay phones in 18 exchanges, according to documents filed with the PSC. If other companies don't move in to BellSouth's vacated areas, about 20 percent of the company's exchanges will have no pay phone, according to the Metro Human Needs Alliance.

Bill Wolfe, *BellSouth to drop pay phones at 3,400 locations in Kentucky,* The Courier-Journal (Louisville, KY), January 3, 2004 (attached as Exhibit 6).

Thus, even if the current level of payphone deployment could be deemed barely adequate, the Commission must still increase the dial-around compensation rate in order to ensure that, as demand for wireless services continues to grow, payphone deployment does not decline further. As discussed above, however, the current deployment level is *not* adequate and should be increased.

Unfortunately, due to the phenomenon of "regulatory lag," it is unlikely that the Commission can increase or even maintain the current payphone deployment level by setting the rate at the level requested by the PSPs. The PSPs' cost studies were conducted more than 18 months ago and were based on the payphone call volumes of 2002. Overall call volumes today may be even lower. Further, due to the six-month lag between the beginning of a dial-around calling period and the date that payment is collected for calls made during that period, the first payments under a new rate may not be received until six months after the rate takes effect. Unless the Commission acts very quickly, therefore, the beneficial effect of an increased rate will not begin to produce results until 2005 at earliest. And if subsequent developments justify additional modification of the rate in the future, the rate will not adjust automatically. There will be further lag prior to the next Commission intervention. For all these reasons, it is critical for the Commission to raise the compensation rate to the new cost-justified level, so that even though the decline in payphone deployment cannot be completely halted, it can at least be slowed.

C. Even If The Commission Could Not Find That The Current Level Of Payphone Deployment Is Inadequate And Would Be Maintained, Applying The Methodology In The *Third Payphone Order* is Needed To Redress The Disproportionate Allocation Of Joint And Common Costs To Coin Calls

Finally, even if the Commission could find that the current level of payphone deployment is adequate *and* will remain so at current rate levels despite a continuing increase in wireless usage, it would still be necessary to increase the dial-around compensation rate, in order to ensure that dial-around rates recover their fair share of joint and common costs. In the *Third Payphone Order* the Commission affirmed that

> dial-around calls [must] contribute a *proportionate* share of the common costs of payphone service . . . [as] an *essential* element of our determination of 'fair compensation' in this context. We find that any other approach would unfairly require one segment of payphone users to disproportionately support the availability of payphones to the benefit of another segment of payphone users. Such subsidies distort competition and appear inconsistent with Congress's directive to eliminate other types of subsidies.

Third Payphone Order at 2570, ¶ 157. (Emphasis added).

Since the *Third Payphone Order* was released, as explained in APCC's comments, the local coin rate has increased from $.35 to $.50 while the dial-around rate has remained artificially capped at $.24. The fixed monthly joint and common costs of a payphone have changed little, while calling volumes at marginal payphones have fallen dramatically. Therefore, it is almost certain that dial-around rates no longer recover a proportionate share of the joint and common costs of a payphone.[8]

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[8] While joint and common payphone costs are overwhelmingly non-usage-sensitive, local coin calling costs include substantial usage-sensitive components (*e.g.*, local exchange carriers' network usage charges and, to a considerable extent, coin collection costs). Wood Reply Dec., ¶ 43 & n.11. Therefore, with the steep reduction in average call volumes at marginal payphones, it is likely that per-call coin calling costs have risen much more slowly than per-call joint and common costs. Accordingly, the local coin rate, which has risen more than 40% while the dial-around rate stayed at $.24, must be recovering a significantly larger share of per-call joint and common costs than the dial-around rate does.

The inadequacy of the dial-around rate makes it especially difficult for PSPs to recover their joint and common costs for payphones that generate a high proportion of coinless calls. For example:

> Pay phones are particularly important for Florida's migrant farm workers, who line up on evenings and weekends to place long-distance calls to family members in their native countries, said Tirso Moreno of the Farmworker Association of Florida office in Apopka. Moreno's organization operates a grocery near a labor camp for 600 workers in south Miami-Dade County. When the store was moved to a new building, the pay-phone owner refused to install phones, Moreno said. At the old site, many of the migrant laborers had relied on the pay phones. "The pay-phone company didn't want to replace them because the people in our community use [prepaid] phone cards, which the phone owners don't profit from," Moreno said.

Wes Smith, *Decrease in pay phones rings alarm; As companies hang up on service, social activists and migrant groups worry*, Orlando (FL) Sentinel, January 13, 2004.

II. APCC'S PROPOSED INCREASE IN THE DIAL-AROUND RATE WILL INCREASE PSPS' REVENUES, AND THE IXCS HAVE NOT DEMONSTRATED OTHERWISE

As discussed herein, the IXCs' elasticity arguments are so fundamentally flawed that they deserve no serious consideration. Indeed, if properly interpreted and supplemented, they would show the opposite of what the IXCs contend. There can be little doubt that a dial-around rate increase will *increase*, not *decrease*, PSPs' revenue.

At the outset, however, it must be stressed that the elasticity argument is legally irrelevant. The Congressional directive that PSPs be "fairly compensated for each and every call" requires that the FCC ensure that PSPs recover their per-call costs for dial-around calls. 47 U.S.C. § 276(b)(1)(A). The FCC cannot deny PSPs cost recovery because of the IXCs' elasticity theory. As APCC explained in its comments, to survive constitutional scrutiny, the FCC must prescribe rates that "enable [a] company to operate successfully to maintain its financial integrity, to attract capital, and to compensate its investors for the rates assumed . . . ." APCC Comments at 12, quoting Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944); see also Permian Basin Rate Cases, 390 U.S. 747, 769-70 (1968) ("price control is 'unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . .'"), quoting Nebbia v. People of State of New York, 291 U.S. 502, 539 (1934); Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989). This well established constitutional principle cannot be circumvented on the basis of a speculative theory regarding the demand elasticities.

But in any event, even if the Commission could consider demand elasticities, the IXCs' argument should be rejected because there is little doubt that an increase in the dial-around rate will increase PSPs' revenues.

A. The IXCs Have Made No Showing That An Increase In The Dial-Around Rate Will Decrease PSPs' Revenues

1. The dial-around compensation scheme's built-in market-based safeguards will ensure an appropriate dial-around rate

Without any meaningful evidence whatever, the IXCs claim that demand for dial-around calls is so price sensitive that any significant dial-around rate increase will cause severe demand suppression and a net reduction in payphone revenues. The IXCs' elasticity argument is riddled with flaws, but the most fundamental flaw is the underlying assumption that PSPs need to be protected from themselves. As APCC explained in its comments, the dial-around compensation scheme contains built-in market-based safeguards against excessive and counterproductive rate increases. APCC Comments at 11-12. Major IXCs already have the capability to block, at a subscriber's request, payphone calls to a given toll-free number – although no IXC claims to have made significant use of this capability. Moreover, if individual PSPs set the dial-around rate too high, the IXCs would have the incentive to introduce targeted call blocking, in order to induce those PSPs to lower their rates.[9]

While these safeguards exist, it is highly unlikely that they would ever be used to a significant degree, since PSPs and IXCs are likely to recognize their mutual interest in negotiating an acceptable rate. But the existence of the safeguards provides a built-in check against any real or imagined danger that the prescribed compensation rate – which the Commission has always made clear is a maximum, "default" rate – could possibly result in undue suppression of demand.[10]

Relying on the market to discipline the dial-around rate is consistent with the Commission's clear preference for a dial-around compensation system in which the dial-around rate is disciplined by market forces. In the *Third Payphone Order* the Commission explained:

> [w]e note that the lack of targeted call blocking is a temporary phenomenon. . . . the ability to develop targeted call blocking technology rests largely with the IXCs. We strongly urge the IXCs to develop targeted call blocking.

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9 In addition, APCC explained that the Commission should assume that PSPs will act in their own economic interests, and will not seek and then adhere to an increased rate if it would reduce their revenues and thus their profitability. Global Crossing argues that it is rational for PSPs to seek a rate increase even if demand is elastic because PSPs are pursuing a strategy of maximizing short term profits while they exit the industry. Global Crossing Comments at 8. Global Crossing has a good imagination. First, the large majority of PSPs are not exiting the industry and Global Crossing produces no evidence to the contrary. Second, if demand is elastic, increasing the dial-around rate will reduce revenues even in the short run. Thus, Global Crossing's assertion that PSPs are seeking to increase the dial-around rate to maximize short term profits is nonsensical.

10 No one argues that there will be no elasticity effects whatever from an increase in the dial-around rate. It is possible that some demand suppression will result. As no carrier has provided any basis to predict that a rate increase would cause a net revenue loss, however, there is no cause for concern about elasticity.

> Targeted call blocking is an essential element to an IXC's ability to negotiate with the PSPs in a true market setting.

Third Payphone Order at 2575, ¶ 67. To encourage the development of a "true market setting" the Commission should adopt the highest justifiable dial-around rate that the record supports.

It is curious that the IXCs, whose payphone-deployment argument rests entirely on deference to "market forces" (*see* Section I.A above) should cite elasticity effects as a major cause for alarm. In light of the market safeguards built into the compensation scheme, there is no cause for concern. Market forces are able to ensure that the PSPs accept a lower rate if necessary to prevent loss of revenue.

Moreover, while there is little risk if the Commission sets the maximum, "default" rate too high, setting the default rate too low will cause payphones to continue to be removed in massive numbers, contrary to the statutory widespread deployment mandate. 47 U.S.C. § 276(b). Thus, the Commission should err on the side of caution and set the highest justifiable rate.

2. The IXCs' elasticity analysis is focused on the wrong rates

Even if there were not market safeguards, the IXCs' elasticity argument must be rejected because it is built on sand. In order to demonstrate that call volumes are highly sensitive to any increase in the dial-around compensation rate, the IXCs attempt to show a correspondence between the amount of increase in the dial-around compensation rate and the amount of decrease in payphone deployment. Global Crossing Comments at 2-3; Sprint Comments at 8; AT&T Comments at 7; WorldCom Comments at 9-10. The IXCs, however, are focused on the wrong rate. To the extent that consumers are price-sensitive, they do not decide whether or not to make a dial-around call based on the dial-around rate that the IXCs pay PSPs, but rather on the total rate, if any, [11] that the consumers pay the IXCs for such calls.

The requested increase in the dial-around rate is only a small fraction of the average rate the IXCs charge their customers for access code calls. Thus, demand suppression, if any, cannot be attributed to the requested increase in the dial-around rate. This is confirmed by AT&T's own data. AT&T asserts that its average per-minute charge for payphone calls billed to AT&T calling card calls was $0.92 in November 1999. AT&T Comments at 9. [12] Assuming that the average calling card call lasts four and a half minutes, the total average cost of making a call at the cited rate is $4.14.[13] The current dial-around rate of $.24 makes up only 5.8 percent of that amount. Even if the Commission increases the dial-around rate from $0.24 to $0.484, and AT&T passed the entire charge through to callers, AT&T's average per-minute rate for payphone dial-around calls would only increase from $0.92 to $0.97,[14] or about five percent. AT&T's "evidence," which attempts to define the elasticity impact of a 40% increase in the calling card rate, proves nothing about the impact of an equivalent percentage increase in the dial-around rate. Indeed, as demonstrated below in Section II.B, if APCC's

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11 AT&T's data analysis focused only on certain access code calls, namely calling card calls. With respect to subscriber 800 calls, the amount paid by the caller is typically zero. Therefore, in the absence of IXC call blocking, there would appear to be no measurable elasticity effect on callers. *See also* discussion below regarding AT&T's failure to show any elasticity effects on subscribers.

12 APCC and the San Diego Owners Association demonstrated in their comments that major IXCs often charge their customers even higher rates for access code calls. APCC Comments at 10-11; San Diego Payphone Owners Association Comments at 2-3.

13 $0.92 x 4.5 minutes = $4.14.

14 Adding APCC's proposed increase in the dial-around rate to the total cost of an AT&T calling card call increases the total cost of such a call to $4.376 ($4.14 + $.236). Dividing $4.376 by four and a half, the number of minutes of the average calling card call, results in a total per-minute cost of $.97.

proposed increase in the dial-around rate is accompanied by a five percent increase in AT&T's calling card rates, PSP revenues would increase substantially.

AT&T is not alone in focusing on the wrong rate in its elasticity analysis. WorldCom argues that payphone deployment is in significant part a function of what it calls the "Blended Payphone Rate." WorldCom Comments at 9-10. The Blended Payphone Rate is defined as the weighted average of the dial-around compensation rate and the coin rate. *Id.* at 9. Thus, rather than analyzing the retail rate that *payphone callers* pay the IXCs for dial-around calls, WorldCom postulates a hybrid rate that is a combination of the retail *coin* rate and the *non-retail* dial-around compensation rate that the IXCs pay to PSPs.

This bizarre blending cannot possibly produce any useful or even coherent results. First, for its data to have any possible relevance to an elasticity argument, WorldCom should have "blended in" the *retail* rates paid for dial-around calls by payphone callers, not the payphone compensation rate paid by the IXCs. Second, WorldCom's focus on a rate that blends coin calls with dial-around calls is misplaced. The only relevant question concerns the impact of increases in the rates callers pay for dial-around calls on dial-around call volumes. WorldCom fails to explain and cannot explain why increases in the local coin rate should be taken into account in an elasticity analysis of dial-around calls. Third, WorldCom should have included 0+ calls in its Blended Payphone Rate, and should have weighted the 0+ rate (as well as other rates) differently in each year to reflect the sharp declines in 0+ call volumes, even relative to other payphone call types. The rates and volumes of 0+ calls would be relevant because, over the years, callers have substituted dial-around calling for 0+ calling. Since 0+ calls are generally more expensive than calling card calls, and have declined much faster than other payphone calls, including 0+ calls in a Blended Payphone Rate would have significantly reduced, if not eliminated, any increase in the Blended Payphone Rate shown by WorldCom's data.

Further, if WorldCom had consistently looked at actual retail rates, as opposed to blending in dial-around compensation rates when it was convenient to do so, it would have attributed a cost of $0.00 to subscriber 800 calls, since payphone users are not charged for such calls. Instead, WorldCom attributed a cost of $0.24 to such calls. In recent years, subscriber 800 calls have been making up a greater and greater share of all dial-around calls. If WorldCom's data had included the caller's $0.00 retail rate for subscriber 800 calls, its Blended Payphone Rate analysis undoubtedly would have shown that the average cost to payphone users of making a dial-around call has actually *decreased* significantly on average over the years.

Indeed, the IXCs' failure to take account of the fact that the IXCs' subscribers, rather than payphone callers, pay for subscriber 800 calls fatally flaws the IXCs' elasticity arguments all by itself. The majority of dial-around calls are subscriber 800 calls, and there is no reason to believe that the volume of subscriber 800 calls is significantly affected by the amount of the dial-around rate. As a result, any increase in the dial-around rate is highly unlikely to have a significant impact on subscriber 800 call volumes.[15]

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15 AT&T asserts that if the Commission increases the dial-around rate, subscriber 800 customers may demand that IXCs block calls originating from payphones. AT&T Comments at 11. AT&T, however, offers absolutely no evidence to support its contention. For example, AT&T does not attempt to demonstrate that there was significant subscriber toll-free call blocking when per-call dial-around compensation rose from zero to $.284 per call. The Commission cannot reasonably reject a cost-justified dial-around rate because of a remote and unsubstantiated possibility that some subscribers may request that IXCs block subscriber 800 calls from payphones.

3. The IXCs incorrectly assume that coincidence equals causation

Not only do the IXCs fail to offer any coherent factual data relevant to dial-around demand elasticities; but they also fail to provide even a plausible theoretical analysis to support their position. Instead, the IXCs try to fob off to the Commission the obvious fallacy that, just because alleged increases in the dial-around rates have *coincided* with lower payphone use, the alleged increases must have *caused* lower payphone use. For example, Global Crossing asserts that

> The Commission now has three years' experience in determining what happens to payphone call volumes and payphone deployment when the average cost of a payphone call is increased dramatically. Specifically, increasing the per-call rate from effectively zero to $0.24 per call *caused* volumes to decrease and total revenues from payphones [to decrease] and, hence payphone deployment to decrease.

Global Crossing Comments at 2-3 (emphasis added). Similarly, WorldCom performs a simple regression which allegedly demonstrates a strong "relation" between payphone rates on the one hand and payphone deployment on the other. WorldCom Comments at 9-10.

Even if the rates examined by the carriers were the correct rates, which as we have explained above in Section II.A2, they were not, the fact that increases in the allegedly relevant rates coincided with massive reductions in call volumes or payphone removals would not prove that the rate increases caused the reductions, any more than the fact that tooth decay coincides with a lower life expectancy proves that tooth decay shortens peoples lives. As in the case of tooth decay, in the case of payphones there are additional factors that appear far more likely than alleged retail rate increases to be the primary cause of the unwanted "effect."

Specifically, lower wireless rates and creative pricing plans are largely responsible for making wireless service more affordable and causing a significant reduction in payphone use. Between 1997 and 2002 the "Cellular CPI" declined almost 33 percent. *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services,* Eighth Report, 18 FCC Rcd 14783, 14827-28, ¶ 92 (2003). And in 1998, AT&T Wireless introduced its digital-one-rate plans in which customers were offered bundles of minutes for a fixed monthly rate. Lower rates and this new pricing scheme, which was copied quickly by virtually all other large providers, significantly increased demand for wireless service, thereby reducing payphone use. *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services,* Fourth Report, 14 FCC Rcd 10145, 10155-56 (1999). Indeed, before AT&T Wireless introduced its digital-one-rate plan, the number of wireless subscribers increased by less than ten percent each year. *Id.* at 10152. But in 1998, the year that AT&T Wireless introduced its pricing plan, the number of wireless subscribers increased 23 percent. *Id.* It is therefore no coincidence that payphone deployment peaked in 1999 and declined thereafter. *Trends in Telephone Service, Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission,* Table 7.6 (2003). Thus, even if coinless calling rates paid by callers did increase coincidentally with a drop in payphone use, the reduction in use has not been caused by increased payphone rates, but rather by the greater affordability of wireless service.

B. An Increase In the Dial-Around Rate Will Increase PSPs' Revenues

Despite the glaring flaws in their argument, discussed above, irrationally the IXCs cling to the argument that the prior increase in the dial-around compensation rate (from zero to $.24) was largely, or at least significantly, responsible for declines in payphone call volumes, and that further increases, therefore, would cause additional declines. In fact, the opposite is true; a dial-around rate increase would almost certainly result in a substantial increase in PSPs' revenues. In order to see why this is the case it is instructive to revisit the numerical example with which AT&T seeks to lend its elasticity theory an aura of legitimacy. As discussed above, AT&T reported that, when its average per-minute charge for payphone calls billed to AT&T calling cards went from $0.65 to $0.92 between November 1998 and November 1999, the demand for such calls dropped 40 percent. AT&T Comments at 9. This fact supposedly demonstrates that an increase in the dial-around rate paid by the IXCs would reduce PSPs' revenues.

AT&T's analysis demonstrates the opposite of what AT&T claims. First, AT&T's analysis suffers from the "coincidence" fallacy discussed above. While AT&T's increase in the per-minute calling card rate may explain some of the decrease in calling card call volumes, there is no reason to assume that the rate increase was the primary factor driving the decrease, as AT&T implies. A large part of the decline is undoubtedly attributable to greater wireless use;[16] other parts of the decline may be attributable to the increasing popularity of pre-paid calling cards; and other parts of the decline may be attributable to other IXCs' gaining additional subscribers to their overall toll service offerings at AT&T's expense. For AT&T to simply show that price increases coincided with call volume decreases and from that conclude that the price increases caused the drop in call volumes is overly simplistic.

Second, even taking AT&T's elasticity theory and data at face value, AT&T does not even demonstrate that demand for its own calling card service is elastic. If the

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[16] Not coincidentally, AT&T's calling card revenue fell by 40 percent at the same time that AT&T Wireless introduced its digital-one-rate plan.

average calling card rate increased 41.5 percent while call volumes decreased 40 percent, AT&T's rate cannot be elastic, because revenues actually increased.

Third, AT&T excludes subscriber 800 calls from its revenue impact analysis. As discussed above, subscriber 800 calls, for which callers pay nothing in any event, would greatly dilute the revenue impact of any dial-around compensation rate increase.

Fourth, even if we disregard all the above flaws, AT&T commits the logical error of assuming that a given percentage increase in the dial-around compensation rate would have the same impact on call volumes as the same percentage increase in retail calling card rates. A simple look at AT&T's numbers shows that these are two entirely separate analyses. As discussed earlier, if the Commission increases the dial-around rate from $0.24 to $0.484, and AT&T passes the entire charge through to callers, AT&T's average per-minute rate for payphone dial-around calls would increase from $0.92 to $0.97, an increase of 5.4 percent.[17] If AT&T's data accurately reflect the elasticity of demand for calling card calls, [18] therefore, increasing the dial-around rate to $.484 per call would reduce payphone calling card volumes by approximately 5.4 percent. APCC's proposed percentage increase in the dial-around rate is much greater than the 5.4 percent revenue reduction that AT&T's data suggest would result. Therefore, the impact on PSPs' dial-around revenues would be quite positive. If one also corrects for the other flaws in AT&T's analysis – its "coincidence" fallacy and exclusion of

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17 Assuming that the average calling card call lasts four and a half minutes, the average calling card call costs AT&T's customers a total of $4.14 ($.92 x 4.5 minutes). Adding APCC's proposed increase in the dial-around rate to the $4.14 increase the total cost of such a call to $4.376 ($4.14 + $.236). Dividing $4.376 by four and a half, the number of minutes of the average calling card call, results in a total per-call cost of $.97.

18 As noted above, AT&T's own data indicate that a 41.5 percent increase in calling card rates results in an approximately 40 percent decrease in call volumes. This means that the elasticity of demand equals approximately one.

subscriber 800 calls, the impact on PSP's dial-around revenues should become even more positive.

In short, AT&T's data actually show that PSP revenues and payphone deployment can both be expected to increase very substantially from an increase in the dial-around rate.[19]

III. THE PAYPHONES IN APCC'S COST STUDY ARE BREAK-EVEN PHONES

The IXCs' argue that some of the 108 payphones in APCC's Cost Study are not "truly" marginal. AT&T Comments at 12-16; WorldCom Comments at 17; Sprint Comments at 12-14. In particular, WorldCom asserts that APCC did not "exclude call volume data from locations that did not fully recover their costs" and that APCC's study "may include phones with sub-marginal volumes." WorldCom Comments at 17. Similarly, AT&T argues that "APCC's study has skewed its results by failing to eliminate from its survey sample payphones that do not allow the owner to 'recoup [their] costs, including earning a normal rate of return.'" AT&T Comments at 14.

The IXCs' criticism is misplaced and demonstrates a fundamental misunderstanding of APCC's Cost Study. While it is true that some payphones in APCC's Cost Study may not recoup all of their costs,[20] it is equally true that some of the payphones generate economic profits. The break-even phone is merely a theoretical

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19 As discussed above, APCC believes that the length of a calling card call is approximately four and a half minutes. However, even assuming that the average calling card call from a payphone lasted only three minutes, the demand for such calls from PSPs' perspective would still be inelastic if the Commission increased the rate to $.484 since call volumes would decrease by approximately only nine percent, far less than the percentage increase in the dial-around rate.

20 AT&T speculates that some of the 108 payphones that APCC identifies as marginal may experience economic losses because some may be "semi-public" payphones for which the premises owner pays some of the cost. Declaration of Robert M. Bell ¶ 11. However, as APCC has previously explained, APCC excluded such phones from its Cost Study. APCC Comments at 17-18. *See also* Wood Reply Dec., ¶ 28.

construct. Wood Reply Dec., ¶¶ 14, 16. In the real world, there are very few phones that "break" exactly "even." On average, however, the 108 payphones in APCC's Cost Study provide a reasonable picture of break-even phones, because when a PSP and location owner agree that no commission will be paid on a payphone, there is an *expectation* that the payphone will earn no more than a normal rate of return; on average, it is reasonable to conclude that that *expectation* will be correct. Wood Reply Dec., ¶ 18.

APCC's use of averages to calculate the number of calls at the marginal payphone is consistent with the FCC's methodology in the *Third Payphone Order.* Wood Reply Dec., ¶¶ 12-14. The FCC based its calculation of marginal payphone call volumes on the RBOCs' findings that: (1) "*on average,* if the payphone had 414 calls per month, the premises owner would not have to pay for the payphone;" and (2) "*on average,* the LEC PSP would have to pay location rents to a premises owner that had a payphone with 464 calls or more per month." *Third Payphone Order* at 2612, ¶ 47. The FCC derived a marginal payphone call volume of 439 by taking the average of these 414 and 464 calls. *Id.* Thus, like APCC's estimate of call volumes from the marginal payphone, the FCC's estimate of 439 calls is the result of a number of averaging calculations. Accordingly, in the *Third Payphone Order,* as in APCC's Cost Study, some marginal payphones will necessarily have economic profits while other will generate economic losses. Wood Reply Dec., ¶ 14

AT&T and WorldCom nevertheless argue that APCC failed to exclude from its study every payphone that generates economic losses. AT&T Comments at 13-15; WorldCom Comments at 17. But of course, excluding these phones would guarantee that the only zero-commission payphones included in APCC's Cost Study would be those that experience high call volumes and generate economic profits. Wood Reply Dec., ¶ 19. A simple example is illustrative. Assume that there were only two phones in APCC's Cost Study and that one had call volumes of 224 per month and the other had call volumes of 244 per month, so that the average break-even phone had call volumes of 234 per month. Clearly, if APCC's Cost Study excluded the payphone with 224 calls per month, call volumes would be inflated. Yet that is precisely what AT&T and WorldCom propose.

AT&T offers an example which allegedly demonstrates that including payphones with economic losses inflates call volumes. AT&T Comments at 15. In fact, the example serves only to expose AT&T's flawed reasoning. AT&T assumes that 50 percent (54 of the 108) of payphones in APCC's Cost Study are "true" break-even phones, while the other half (the remaining 54) failed to recoup costs. *Id.* AT&T assumes that the 54 "true" break-even phones generate 400 calls per month while the other half generate 68 calls per month. *Id.* AT&T explains that "the average number of calls across all 108 payphones would be 234 (the same as in the APCC study). However, the correct average, that for the truly marginal payphones, would be 400, more than 70 percent higher than the number APCC puts forward." *Id.* But AT&T's assumption that half of the payphones in APCC's Cost Study break even is nonsensical since, as explained above, there are virtually no "truly marginal payphones" in the real world or in APCC's Cost Study. There are only payphones that generate slight economic profits or slight economic losses. Thus AT&T, in its example, should have assumed that half of the payphones in APCC's Cost Study generated economic profits and that half generated economic losses. Wood Reply Dec., ¶ 22. Under this correct assumption, APCC correctly took the average of *all* phones to identify the call volume that will allow the average payphone to just break even.

IV. A NEW DIAL-AROUND RATE SHOULD FACTOR IN COLLECTION COSTS AND BAD DEBT

A. Expenses Incurred In Collecting Dial-Around Compensation Are Significant And Should Be Included In The Compensation Rate

AT&T argues that collection expenses will go down in the future because of the Commission's recent rule change returning to a system under which switch-based resellers pay for calls completed from their call processing platforms. AT&T Comments at 23. In fact, collection expenses are likely to increase under that order.

In the past PSPs have actually collected dial-around payments from a relatively small group of carriers. In the pre-November 23, 2001 period, the number of payers was limited because it was so difficult to identify which of the switch-based resellers responsible for payments and determine which of them were worth pursuing. See *Pay Telephone Reclassification and Compensation Provisions of the Telecommnications Act of 1996*, Report and Order, CC Dkt. No. 96-128, FCC 03-235 (Rel. Oct. 3, 2003), ¶¶ 18-19. In the post-November 23, 2001 period, the number of payers has been limited because it has not been necessary to collect from switch-based resellers. *Id.*, ¶ 20. Under the latest order, PSPs will once again be required to collect from switch-based resellers, but they will be provided more information about those SBRs and the calls routed to them. *Id.*, ¶¶ 38-41, 44-45, 51-54. As a result, PSPs will be seeking to collect payment from more IXCs than ever before, and collection expenses will increase. Further, because more call data will be available to PSPs, more money may be spent on data analysis related to collections activity.

The IXCs also argue that collection expenses, such as fees paid by PSPs to APCCS, are already fairly represented in SG&A. AT&T Comments at 23; WorldCom Comments at 16.

As explained in APCC's comments, in the *Third Payphone Order* the Commission accounted for certain collection costs by including them in SG&A, but did not account at all for other collection costs.[21] Just as SG&A does not include the specific coin collection costs incurred in making trips to payphones to collect coins, SG&A also does not include the specific dial-around collections costs incurred in hiring aggregators to submit claims and evaluate and process dial-around payments, or in pursuing litigation against non-paying or underpaying the IXCs. The APCC Cost Study's estimate of $.007 per call in collection costs includes these aggregator and litigation fees and expenses, but excludes individual PSPs' record-keeping costs, assuming that the latter costs are included in SG&A.

WorldCom claims that APCC's cost study survey did not direct PSPs to exclude APCC's fees from SG&A. WorldCom Comments at 16. However, there is no reason to assume that PSPs would include such specific fees and expenses in a generic category such as SG&A.

B. The Commission Should Factor Bad Debt Into The New Dial-Around Compensation Rate

PSPs frequently are never paid the dial–around compensation that they are owed. Any rate that does not factor in bad debt would therefore undercompensate

[21] The Commission, in the *Third Payphone Order*, included billing expenses in SG&A, but did not account at all for payments made by PSPs to aggregators who provide services used to collect dial-around compensation.

PSPs. The APCC Cost Study includes bad debt by including in its determination of call volumes only those calls for which PSPs were actually compensated.

Some IXCs argue that factoring in bad debt is prohibited, citing *Illinois Pub. Telecom. Ass'n v. FCC, 117 F.3d 555 (D.C. Cir. 1997)("IPTA")*. WorldCom Comments at 16; Sprint Comments at 14. This is simply wrong. The FCC routinely approves bad debt for a cost element, *e.g.*, in access charges. *See* RBOC Coalition Comments at 12, n.4. It is common for businesses that face bad debt to recover the bad debt in their prices.[22] The IXCs have not presented a single reason why PSPs should not be afforded the same opportunity as every other business to recover their bad debt.

The payphone compensation cases on which the IXCs rely have no application here. In *IPTA*, the D.C. Circuit found it arbitrary and capricious for the Commission to exempt small carriers from any dial-around compensation obligation. As stated by the Court, "[A]dministrative convenience cannot possibly justify an interim plan that *exempts* all but large IXCs from paying for the costs of services received." *IPTA* at 565 (emphasis added). APCC's cost study would not *exempt* any carrier from paying compensation. Rather, it merely seeks to ensure that the rate assessed against all carriers takes account of the fact that inevitably, there will be some carriers from whom PSPs simply cannot collect payment.

Similarly, the Commission's *Fifth Order on Reconsideration*, also cited by the IXCs, provides no support for their position. *Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Fifth Order on Reconsideration and

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22 Sprint has previously acknowledged that, as a facilities-based IXC, it incurs an 8% bad debt rate in its collection of revenue from switch-based resellers. Sprint presumably attempts to recover these costs in calculating the rates to be charged to and collected from its paying customers. In its comments, however, Sprint argues that bad debt should not be similarly factored into the dial-around compensation rates charged by PSPs.

Order on Remand, 17 FCC Rcd 21274 (2002) ("*Fifth Order on Reconsideration*"). In the *Fifth Order on Reconsideration*, the Commission ruled that it was not inequitable to require PSPs to refund the full difference between the initially prescribed rate and a lower rate prescribed after a remand by the court of appeals. Even though PSPs had not collected the full amount due from all IXCs, the Commission reasoned that carriers who paid their compensation obligations would be unfairly penalized if they were deprived of refunds to make up for the failure of other carriers to pay their share. The *Fifth Order on Reconsideration*, however, was a retroactive adjustment to a scheme already in place. In the instant case, the new rate would be applied on a purely prospective basis. The Commission is determining the basis for each carrier's "fair share" of compensation going forward. When making rules prospectively, the Commission is not permitted to disregard costs such as bad debt.

Additionally, some IXCs pluck language from *APCC v. FCC*, 215 F.3d 51 (D.C. Cir. 2000), the D.C. Circuit decision upholding the *Third Payphone Order* to mistakenly argue that either the Commission or the D.C. Circuit has ruled that allowances for bad debt are not permitted under Section 276. Sprint Comments at 13, 17. But there is no such ruling. As the D.C. Circuit explained, the Commission simply found, because of "insufficient information . . . 'that it would be unwise to establish a cost element for bad debt at this time.'" *APCC v. FCC* at 55-56. The purely "evidentiary basis" on which the Commission made its decision was further underscored by the Court's insistence that the Commission "could have formulated some best guess figure for bad debt, but we [the Court] cannot require an agency to enter precise predictive judgments. . . ." *Id.*

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[16] Significantly, even in the Fifth Order on Reconsideration, the Commission did not consider itself bound to include resellers in all payments for all periods. See Fifth Order on Reconsideration, ¶ 60.

The IXCs also contend that, under the recent SBR order, there will be less bad debt in the future. AT&T Comments at 22. There is no basis for this assumption. As explained in APCC's Petition for Reconsideration or Clarification, CC Dkt No. 96-128, filed December 8, 2003, despite the additional information that will be available, the current rules are likely to cause the same kinds of difficulties collecting from resellers as PSPs experienced in the 1999-2001 period. For example, there was a large group of SBRs for which the probable cost of collecting dial-around compensation exceeded the expected recovery from any individual SBR. Another large group of delinquent SBRs, including *e.g.*, Twister Communication Network, Inc., PT-1 Communications, Inc., Equalnet Corp., WorldAccess, Inc., Vocall Communications Corp., ESSENTIAL.COM, ESS.COM, RapidLink USA, ATX Telecommunications Services, RSL Comm, U.S.A., Inc., Viva Telecom, Pointe Communications Inc., and Reams Communications, Inc., went into bankruptcy, thereby frustrating PSPs' attempts to collect some or all of the SBR's unpaid compensation obligations. Moreover, the bad debt problems for PSPs are not limited to resellers. For example, WorldCom and Global Crossing both ceased payments for certain quarters when they went into bankruptcy, dramatically reducing the compensation payments received by PSPs.

APCC has found a way, albeit a very conservative one,[23] to partially factor in bad debt without having to develop a specific estimate of uncollected calls, by simply counting the number of *paid* calls. The IXCs claim that this is somehow a "manipulation" of call counts. Yet, it is in fact the most precise call count available to PSPs. PSPs know precisely how many calls they have been paid for. The number of

[23] In fact, APCC's method underestimates the per-call cost of bad debt, because it treats bad debt, in effect, as a subtraction from joint and common costs, rather than as an allowance to be subtracted from the revenue requirement to be collected solely from dial-around calls.

calls actually completed is much more difficult for PSPs to determine precisely, due to the well-known problems involved in PSPs' maintaining payphone call detail records and determining call completion. That is presumably why the Commission assigned call tracking responsibility to carriers. Yet, none of the carriers is willing to provide a call count of its own. If carriers are not satisfied that APCC's call counts are correct, then it is incumbent on the carriers to estimate the quantity of those calls, or at a minimum to identify some mechanism by which the volume of yet-to-be-paid-for calls can be fairly determined.

The IXCs object to APCC's method of factoring in bad debt by including only paid dial-around call volumes, on the grounds that it would allow PSPs to double recover. AT&T Comments at 16. Sprint Comments at 13, 17. To address this concern, APCC has updated its cost study by reviewing compensation payments made since the study data were collected. The dial-around call volumes used in APCC's cost study are based on the average monthly payments received for marginal phones in the April 2002 payment for dial-around calls made during the fourth quarter of 2001. Since the study was conducted, seven additional payment cycles have occurred. During that time, there has been a net change of 7% in the paid dial-around call volume for that period. This translates into a $.008 reduction in the proposed dial-around rate. Accordingly, APCC censes its proposed rate from $.484 to $.476. The trend of the change in paid calls suggests that it is unlikely that any further significant payments will be collected for the sample quarter. Therefore, based on the record of payments, the Commission need not be concerned about the possibility of further double recovery.

V. THE IXCS' OBJECTIONS TO THE COST DETERMINATIONS IN THE APCC COST STUDY ARE WITHOUT MERIT

A. There Is No Reason To Believe APCC's Cost Study Data Collection Methods Resulted In Significantly Biased Responses

AT&T argues that there is a potential for bias in APCC's cost study. AT&T Comments at 15 n.10. As explained by Don Wood, however, whatever the abstract *potential* for bias, there is no evidence or reason to believe actual bias occurred. Wood Reply Dec., ¶¶ 29-32. The rate of response to APCC's cost study survey exceeds typical survey response rates. Further, there is no evidence supporting AT&T's assumption that survey respondents were aware that they "stood to benefit if the APCC study showed a low volume of calls and high [per-location] costs." The survey instrument and instructions were carefully designed to avoid unnecessary discussion of the manner in which the results would be used, and all contact between respondents and APCC was strictly limited. *Id.*, ¶ 30. Moreover, feedback by respondents suggested absolutely no insight whatsoever into even the basic question of whether a higher or lower reported call count would impact the results in a "beneficial" way. AT&T assumes an awareness and understanding of the Commission's methodology that, by all appearances, simply does not exist. *Id.*, ¶ 31.

Further, in order for a potential respondent to make a strategic decision to "self select" itself as a non-respondent, as AT&T argues, the potential respondent would need to have some insight into both its own characteristics and how those characteristics compare to an average or baseline value for other providers. *Id.*, ¶ 32. There is absolutely no evidence that any potential respondents had knowledge of how its characteristics compared to the average, or any basis upon which to strategically withhold its information in hopes of influencing the study result in a "beneficial" direction. *Id.*, ¶ 33.

B. The Rate of Return Assumption Used in the Study Is Reasonable

Sprint argues that the rate of return assumption of 11.25% is not reasonable and that "IRS overpayment rates" should be utilized as a proxy for the "time value of money." Sprint Comments at 15. The Commission has twice upheld the 11.25% figure for application to payphone compensation. *Third Payphone Order* at 2630, ¶ 187; *Fifth Reconsideration Order* at 12, ¶ 31. Sprint has provided no persuasive reason to overrule those precedents.

Further, as APCC's consultant Don Wood explains, the appropriate cost of capital in an analysis such as this one must reflect both the current state of financial markets and a risk level that is specific to the industry and to the operations of the specific company in question. Payphone providers, even those that are demonstrably well managed, have consistently reported an inability to obtain capital and have obtained capital (primarily debt) only at high rates. The 11.25% used in the APCC study reasonably reflects the current level of risk. Wood Reply Dec., ¶ 34.

C. The Equipment Cost Assumptions Used in the APCC Study Are Reasonable

The commenters argue that the equipment investment values included in the Dial-Around Cost Study are inappropriate because they fail to reflect accumulated depreciation of the embedded base of assets. AT&T Comments at 19-20; Sprint Comments at 15. The Commission correctly rejected this argument in the *Third Payphone Order,* ¶ 131, and there is no reason to revisit it. The Commission has consistently defined the cost basis for a bottom-up methodology to be forward-looking, and for good reason. Rational economic decisions are based on the replacement cost, not booked cost, of assets. If payphone providers are permitted to recover only booked investment minus accumulated depreciation, they will be unable to invest in replacement assets when the existing assets reach the end of their useful life. Wood Reply Dec., ¶ 35.

WorldCom argues that APCC's study is flawed because it failed to utilize used equipment prices in estimating equipment costs. WorldCom Comments at 11-15. In fact, equipment prices used in the APCC study consider the acquisition cost of used equipment, provided that the used equipment has been fully restored to like-new condition in terms of appearance and operation. The equipment considered consists of "smart" phones, as deployed by independent payphone providers (and ILEC providers on a going-forward basis). Wood Reply Dec., ¶ 36. By contrast, the printouts from various websites attached to WorldCom's comments include any of these phones are "dumb" sets, liquidation items of unknown origin, items posted on an "eBay-like" board, or simply novelty items. These prices have no credibility or relevance to APCC's study. *Id.*, ¶ 37.

Moreover, when calculating maintenance costs, APCC's study assumed the equipment put into place would begin in new or, if refurbished, like-new condition. If the Commission were to use an equipment cost input that reflects lower quality equipment, it would be necessary to simultaneously increase the cost of the maintenance required for these units to an appropriate level. *Id.*, ¶ 38.

D. The Level of ILEC Line Costs Is Reasonable

Sprint argues that the inputs to the APCC Study related to ILEC line charges are overstated because "payphones have enjoyed significant reductions in their line costs, as a result of state implementation of the new services test." Sprint Comments at 17. The APCC study inputs used the ILEC line rates in effect for each location studied as of 2Q 2002. Wood Reply Dec., ¶ 40. At that time, the FCC's order requiring application of the new services test to line rates had been in effect for five years, and the Common Carrier Bureau guidelines clarifying the new services test for State public service commissions had been available for two years. *Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* Order on Reconsideration, 11 FCC Rcd 21233, 21307-08 (1996) (requiring States to apply the new services test); *Order,* 12 FCC Rcd 21370 (Com. Car. Bur. 1997) (setting a May 19, 1997 deadline for implementing the new services test); *Wisconsin Public Service Commission,* Order, 15 FCC Rcd 9978 (Com. Car. Bur. 2000) (clarifying application of the test). The IXCs provide no valid basis to conclude that the APCC Study line rates element is overstated.

It is interesting that Sprint, of all carriers, should claim that APCC has overestimated line rates. The federal new services test requirement applies to the RBOCs, but not to Sprint or other independent ILECs. *Wisconsin Public Service Commission,* Memorandum Opinion and Order, 17 FCC 2d 2051, 2064, ¶ 42 (2002). In fact, Sprint continues to have the highest rates for payphone access services of any Tier 1 ILEC, and has consistently been the ILEC most reluctant to engage in serious line rate negotiations with payphone providers. Wood Reply Dec., ¶ 39. Sprint cannot credibly argue that line rate costs to payphone providers have decreased.

E. AT&T's "Top-Down" Test Deserves No Consideration

Commenters argue that the Commission's previous top-down approach must be used to assess the reasonableness of the results of any bottom-up analysis. AT&T Comments at 24; Sprint Comments at 16. The *Third Payphone Order,* however, does not require any top-down "validation" and makes clear that the bottom-up approach is the *only* accepted means of calculating a change to the dial-around compensation rate. Furthermore, the Commission acknowledged that it used the top-down methodology in the *Third Payphone Order* merely for purposes of "test[ing] the reasonableness" of its bottom-up calculation. *Third Payphone Order* at 2572, ¶60. Since the Commission, in the *Third Payphone Order*, made it clear that the top-down methodology is flawed, *id.* the Commission must have used the top-down methodology for no other reason than to obtain a measure of comfort that its bottom-up methodology is valid. The Commission, therefore, did not *rely* on the top-down methodology in reaching its decision to use the $0.24 rate; as a result, the Commission need apply the top-down methodology to validate APCC's proposed rate of $0.484. *Z-Tel Communications, Inc. v. FCC*, 333 F.3d 262, 270-72 (D.C. Cir. 2003) (holding that the Commission did not "rely" on data that the Commission used only to obtain further assurance that its conclusion was correct.); *AT&T Corp. v. FCC*, 220 F.3d 607, 625 (D.C. Cir. 2000).

As APCC's consultant shows, the assumptions underlying the "taking comfort" top-down analysis in the *Third Payphone Order* are unlikely to remain valid when there have been substantial changes in coin call volumes. Since many of the costs defined as coin-only are partially or totally volume insensitive, application of the top-down method can produce cost "reductions" that are independent of the level of non-coin costs and the number of non-coin calls. By contrast, the bottom-up methodology excludes coin mechanism, coin collection, and local termination costs completely, and thus separates the recovery of coin-related costs from the recovery of other location costs. This separation permits a "fair" rate for dial-around calls to be calculated based on the recovery of fixed (non-coin) location costs. Wood Reply Dec., ¶¶ 43-44.

Therefore, any results generated by the application of the top down methodology, even if properly conducted, may offer little insight at this time. As the Commission has concluded:

> if our goal is to price dial-around calls such that they make a proportionate contribution to joint and common costs, we cannot do so by basing their price on the local coin calling price, because we do not know how individual PSPs price local coin calls in relation to the recovery of joint and common costs. Therefore, upon reconsideration, we find unreliable the assumption that PSPs set prices so that each call recovers an equal amount of joint and common cost.

Third Payphone Order, ¶ 70. The top down methodology assumes a given and fixed ratio of coin to non-coin calls, and assumes that a rational pricing strategy for payphone providers would be to attempt to equalize the margin among all call types at all locations. These assumptions may or may not be valid. While the Commission may have found some comfort in the observation that similar results have been generated by these two fundamentally different methodologies in the past, there is no necessity for such similarities to exist now or in the future. AT&T's assertion that the results of the Dial-Around Cost Study should be called into question because they cannot be reconciled with AT&T's (flawed) application of the top down methodology has no basis in basic economic concepts, and is not supported by the Commission's conclusions in the *Third Payphone Order*. Wood Reply Dec., ¶ 45.

F. The IXCs' Other Objections Have No Merit

An increase in the dial-around rate would not hurt consumers, as WorldCom alleges. WorldCom Comments at 10. The reduction in payphone deployment resulting from a failure to increase the dial-around rate would cause far more to the public interest than an economically sound, cost-justified rate increase.

WorldCom's argument that a cost-based per-call rate should be reduced by the extent to which coin revenues "overcontribute" to joint and common costs is incoherent. WorldCom Comments at 17. To the extent it can be comprehended, it appears to rest on the obviously false assumption that there are no coin-only costs.

Apart from its questionable factual basis,[24] WorldCom's contention that the per-call compensation should be reduced to compensate for an alleged overrecovery in the per-payphone surrogate rate is illogical. If WorldCom believes that the per-payphone surrogate rate is too high, then it should request a reduction in that rate. WorldCom Comments at 18. To the extent WorldCom is arguing that the Commission should lower the per-call rate prospectively to provide retroactive relief for past application of allegedly excessive rates, its proposal is in conflict with generally accepted principles concerning retroactive ratemaking. This rulemaking proceeding is *de novo*, not a follow-up to a remand from the court of appeals.

Sprint characterizes any increase in the dial-around rate as a subsidy. Sprint Comments at 5. Obviously, correct application of the *Third Payphone Order* methodology will produce cost recovery, not a subsidy. Sprint also alleges that declining payphone-deployment is the self-inflicted result of poor service, poor maintenance, and excessive rates for coin calls and 0+ calls. Sprint Comments at 7. It is not clear what, if any relevance this argument has. But in any event, Sprint's argument is refuted by Sprint's own factual admissions. Sprint has conceded that its own payphone operations have shrunk considerably, even though Sprint claims it is running its payphone business responsibly. *Id.* at 8. If Sprint's deployment declines are not self-inflicted, there is no apparent reason why the overall deployment decline should be deemed self-inflicted.

Finally, Sprint urges the Commission to consider additional revenue sources such as payments by the location owner to the PSP, advertising, and Internet access.

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24 APCC Services' figures indicate that the number of per-payphone payments has been steadily declining. The major IXC that most often pays surrogates, currently does not currently pays surrogates on only approximately 12.5% of APCC Services-represented ANIs. Many IXCs pay no surrogates.

Id. at 18. Payments by the location owner, of course, are irrelevant to cost recovery for marginal payphones, since marginal payphones are defined as phones for which there is *no* payment by the location owner. Consideration of revenue from advertising and Internet access is inappropriate for the reasons stated in APCC's comments. Even if advertising revenue could be properly considered, the RBOC Coalition's comments confirm APCC's showing that any advertising revenue derived from marginal phones would have a negligible impact on the compensation rate.

VI. THE THIRD PAYPHONE ORDER METHODOLOGY SHOULD NOT BE REPLACED WITH A CALLER-PAYS SYSTEM

Sprint describes a caller-pays system as "[t]he only true-market-based system." Sprint Comments at 19. By its very nature, caller-pays cannot provide a "true" market test of demand for "toll-free" dial-around calls. The product that carriers are providing to the public when they handle "toll-free" dial-around calls is called "toll-free service." "Toll-free" means the caller pays *nothing* to make the call. If the Commission required PSPs to charge callers coins to make "toll-free" calls, that would completely change the nature of "toll-free" service. Caller-pays might serve as a market test for some new type of toll service, but it cannot test the market for placing "toll-free" dial-around calls at payphones. If Sprint wants the Commission to consider experimenting with the toll-free service market by introducing a new "not really free" toll-free service, Sprint should first market-test the service on its own payphones first.

Apart from the fact that caller-pays changes the nature of the service, caller-pays also changes the nature of payphones. As explained in APCC's comments, part of the value of payphone service today is that it is possible to use a payphone even if one does not have coins. Caller-pays would simply eliminate that aspect of payphone service.

All payphone calls (except 911 and relay service) would become coin calls.[25] While Sprint states that 0+ calls could still be made in a caller-pays system, Sprint neglects to mention that 0+ calls as well would become "caller-pays" 0+ calls, because Section 226(c)(1) of the Act prevents PSPs from requiring "advance deposits" for dial-around calls unless they also require "advance deposits" for 0+ calls. 47 U.S.C. § 226(c)(1).

By requiring payphones alone to charge callers for each "toll-free" call, and by eliminating all coinless calling options from payphones, Sprint's caller-pays proposal would do more than even wireless service to kill demand for payphone calling. The Commission has rebuffed Sprint's caller-pays proposal, not only in the *Third Payphone Order*, but on every one of the many prior occasions when Sprint has urged it upon the Commission. Sprint offers no more compelling reason to consider caller-pays than it offered on any of the other occasions when the Commission correctly declined to endorse it.

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[25] Sprint suggests that credit cards (e.g., VISA, American Express) could be used by the caller to pay for the payphone in lieu of coins, but this is surely a joke. Sprint does not attempt to explain where lower-income consumers and immigrants – those who rely most on payphones – would obtain VISA or AMEX cards. Nor does Sprint try to explain where PSPs would get the capital to install credit card processing devices in their payphones. Whatever the inefficiencies of the current dial-around payment system, at least there is a system in place for paying PSPs and passing the compensation fee on to end users. By contrast, there is no system for handling payphone compensation by means of credit cards. Indeed, there are few if any locations, outside of major airports, where one can find any payphones that accept credit card swipes. An effective credit card compensation system would require organizations like VISA and American Express to set themselves up to handle billions of individual 50-cent charges, and would require PSPs to install credit card swiping and processing equipment in every payphone.

CONCLUSION

For the foregoing reasons, the Commission should amend its rules to increase the dial-around compensation rate to an amount that enables PSPs to recover the costs of a marginal payphone, as demonstrated in this proceeding.

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Respectfully submitted,

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